Rethinking the Political Economy of "Developmentalism"

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Introduction

"Developmentalism" is the term that the late Prof. Murakami created to explain the miraculous developmental experiences of the East Asian countries, including Japan (Murakami 1996). He defines the developmentalism as "an economic system that takes a system of private property rights and a market economy as its basic framework, but that makes its main objective the achievement of industrialization, and insofar as it is useful in achieving this objective, approves government intervention in the market from long-term perspective". Also he states that "developmentalism is a political-economic system established with the state as its unit," and it is "the theory, or policy, of industrialization from the standpoint of nationalism and is thus an advanced form of mercantilism or the view held by the German historical school". Accepting his basic ideas, I will now redefine the term "developmentalism" to involve: "those government-led industrialization strategies which aim to construct an independent national economy, in order to catch-up with the developed countries".

In chapter 1 we present an overview of the main pillars of the early developmentalism that had prevailed in 1950s and 60s. The industrial strategy that was advocated during this era was to aim for "the internalization of the pecuniary external economies".

In chapter 2 we present an overview of the new developmentalism that was constructed by the miraculous industrial experiences of the

East Asian countries which beginning in the 1970s. The new developmentalism is characterized by the combination of the positive intervention of the government to the market and an authoritarian political regime.

In chapter 3 we compare the early version of developmentalism with that of the new version to find out both the common threads and differences. Doing so, we will find out it is not the authoritarian political regime but the creation of a socio-economic system to ensure highly productive and cheap labor that is the crucial factor for the successful developmentalism.

1. The Main Pillars of the Early Developmentalism

1-1 Economics of the Early Developmentalism

Early developmentalism is represented by the "structuralist" approach to development economics. That is the development economics consists of mainly four hypotheses, namely, (a) supply constraint, (b) export pessimism, (c) market failure, and (d) late-industrialization.

The supply constraint hypothesis is based on the idea that deficiencies of supply side factors hamper the economic development of developing countries. Among others the structuralists stressed the scarcity of capital, namely savings and investment. They stressed that the developing countries can not develop because of capital scarcity. Foreign exchange constraints and food shortage are variations of supply constraint hypothesis.

The export pessimism, commonly known as the Prebish-Singer hypothesis, is the idea that the primary exports do not lead to economic development of developing countries. As a result of this idea, the structuralists proposed import-substituting industrialization as the desirable development strategy.

The market failure hypothesis is based on the structuralism inherited from the Keynesian economics (Arndt 1985). That is the disbelief in market mechanism, so that the idea that the planning and the regulations by the central government are necessary for economic development of developing countries.

Gershenkron presented a representative argument of the late-industrialization model (Gershenkron 1966). He described the differences in the speed and character of industrial development of nineteenth European countries according to the degree of relative backwardness. According to him, the more backward the country, the more discontinuous industrialization, i.e., "the big spurt" occurred. That is the hypothesis that seeks the possibility of catching-up with the more advanced countries. He stressed the fact that specific institutions such as long-term industrial bank in case of Germany and the state in case of Russia played the decisive roles for promoting industrialization at the early stage of economic development. These institutions are innovations for catching-up with the advanced countries by reducing risk or transaction costs at the early stage of economic development. Gershenkron also stressed the decisive role of ideology based on nationalism for promoting industrialization.

1-2 Development Strategy of the Early Developmentalism

The industrialization strategy of early developmentalism is based on these four hypothesis mentioned above. The "balanced growth" strategy advocated by Nurkse and "Big Push" strategy advocated by Rosenstein-Rodan are typical examples.

Nurkse asserted that for the developing countries to breakaway from "vicious circle of poverty" the balanced growth strategy was a must (Nurkse 1953). The balanced growth strategy is a development strategy aimed at "the total expansion of the market" through investment of capital in widely different industries at the same time. According to Nurkse, the newly created industries at the same time create demands among each other so that the developing countries can overcome the vicious circle of poverty. His argument is an application of the Adam Smith's insight that the economic development can be brought by the expansion of the market and development of the division of labor. However, Nurkse's argument has not the slightest belief in the "invisible hand" that Smith had. Balanced growth strategy was a growth model that presupposed the centrally planned economic system under the strong government. He not only presupposed that in the developing countries, the market mechanism did not work, but also the market system could not induce economic development.

This unique combination of the Smithian world of market expansion and the belief in a centrally planned economic system is shared by Rosenstein-Rodan, another representative figure of the structuralism (Rosenstein-Rodan 1943). His idea was such that "the whole of the industry to be created is to be treated and planned like one huge firm or trust". The reason why the large planned investment (i.e., the Big Push) is favorable lies in the fact that it creates the complementarity of different industries. The planned creation of such a complementarity system reduces the risk of not being able to sell, and, since risk can be considered as cost, it reduces costs.

He called this as "a special case of external economies". And he asserted that "if we create a sufficiently large investment unit by including all the new industries of the region, external economies will become internal profits out of which dividends may be paid easily".

Corresponding to Rosenstein-Rodan's argument Scitovsky further clarified the meanings of external economies (Schitovsky 1954). He stressed that the concept of external economies has been used in two entirely different contexts. One of these is "technological external economies" used in the context of equilibrium theory, defined as external economies produced by the direct interdependence among economic agents in the sense that it does not operate through the market mechanism. Technological external economies exist whenever the output of a firm depends not only on the factors of production utilized by this firm but also on the output and factor utilization of another firm or group of firms.

Another concept of external economies is that to be used in the context of the theory of industrialization of underdeveloped countries, where the concept is used in connection with the special problems of allocating savings among alternative investment opportunities. He called this type of external economy the "pecuniary external economies", that include not only direct or non-market interdependence among producers but also include interdependence among producers through the market mechanism. If there are pecuniary external economies then the investment in an industry leads to an expansion of its capacity and may thus lower the prices of its products and raise the prices of the factors used by it. The lowering of product prices benefits the users of these products; the raising of factor prices benefits the suppliers of the factors. Schitovsky asserted that if expansion of different industries were integrated and planned together, the profitability of investment in each one of them would be a reliable index of its social desirability.

1-3 The Typical Case of the Early Developmentalism

The Indian experience of independence was a pioneering case for many newly independent countries and her industrial strategy was a glittering model that could be learnt by the then developing countries. The main characteristics of the Indian industrial strategy are summarized in three points (Chakravarty 1987).

First, India adopted a development planning based on the famous Mahalanobis growth model that aims to achieve higher economic growth in the long term point of view by promoting heavy industry. This was realized as the Second and the Third Five Year Plans. This development strategy demanded the curtailment of consumption for promoting domestic savings and investment under the strong guidance of the government. The Mahalanobis model adopted basically a supply-side view and it did not consider demand-side bottlenecks.

Secondly, India established a mixed economy system in which the public sector occupied a clearly dominant position. The Industrial

Policy Statement in 1956 demarcated industries into three categories, and all the basic industries were conducted by the public sector enterprises. On top of this strict regulations through a licensing system were imposed on the private sector when private sector companies wanted to set up new factory, to expand their productive capacity, to manufacture new products, or to change their location.

Thirdly, India adopted an import substituting industrialization strategy, aiming to establish a production base for the domestic market by the Indian enterprises.

Nehru called the objective for India's society as "the socialistic pattern of society". India's development strategy was colored by anti-colonialism and her industrial strategy was a typical case of the early developmentalism.

2. The Industrialization of the East Asian Countries and the New Developmentalism

The neo-classical approach has thoroughly dominated the domain of development economics since the 1980s, endorsed by international institutions such as the IMF and the World Bank. The advocates of the neo-classical approach asserted that "market liberalization" and "export-orientation" are the two indispensable factors for successful development of the developing countries. However, in the latter half of the 1980s, there appeared a variety of criticisms against the validity of the neo-classical approach. One of the most noteworthy trends was the emergence of the new version of developmentalism, depending on the miraculous growth experiences of the East Asian countries.

2-1 The Political Economy of the New Developmentalism

A series of Jeffry Sachs' papers on the comparative studies of structural adjustment in Latin American countries and East Asian countries in 1980s shows well the characteristics of the new developmentalism.

He explained the differences of economic performance of both regions in terms of the differences of exchange rate and trade system (Sachs 1985). In Latin American countries governments allocated borrowed funds to import-substituting sector and service sector (non-tradables); on the other hand East Asian governments allocated borrowed funds to tradables. The allocation of resources between tradables and non-tradables depends on trade policies, exchange rate management, and aggregate demand management. Sachs further argued that in East Asia it was rural political power that supported the export-oriented trade policies and devaluation. On the other hand, it was unionized urban workers who supported overvalued exchange rates. He concludes that the "difference in labor market organization certainly plays an important role in the political calculus".

Looking back on the East Asian experiences Sachs discussed that "outward-oriented strategy" and "market liberalization" is not the same thing (Sachs 1987). He further discussed that as a policy tool of crisis management for debt burdened countries, the market liberalization was not a proper course to follow. This was because: (1) This strategy is not supported historically. The success stories of East Asian countries do not demonstrate the utility of trade liberalization in the midst of a macroeconomic crisis. "Stabilization" and the "liberalization" have conflicting requirements. (2) The East Asian experience suggests that export promotion policies can be pursued by a dirigiste government, and even in the presence of tight import controls and tight regulations in the capital market. (3) The East Asian experience suggests that successful development might be helped as much by raising the quality of public sector management as by privatizing public enterprises or liberalizing markets. (4) In East Asian countries governments promoted relatively equal income distributions, most fundamentally through policies that equalized the rural income distribution and that kept the urban rural differentials much narrower than in other developing countries. This relative equal income distribution in East Asia freed the hand of governments to focus on issues of efficiency.

As is clear from the arguments of Sachs, the characteristics of the political economy of the new developmentalism lies in the assertion that on the one hand the export oriented strategy is as valid the neo-classical approach asserted, but on the other hand that the strategies that have worked are essentially different from the market liberalization strategy.

2-2 Industrial Policy of the New Developmentalism

The experiences of industrialization in the East Asian countries led to the reassessment of the role of the government as a promoter of economic development. In particular, a lot of attention has been paid to the decisive role of industrial policies.

In his beautifully written paper Prof. Komiya, the pioneer of Japanese industrial policy studies, argued that the content of industrial policy in the narrow sense should be defined to those "interventions to cope with failures in the market, or price system, that affect resource allocation". The industrial policy in the narrow sense means policies that affect the allocation of resources to industry, including (a) items that affect the infrastructure of industry in general, such as the provision of industrial sites, roads and ports, industrial water supplies, and electric power; and (b) items that affect inter-industry resource allocation (Komiya 1988). His definition of industrial policy stands on the rather orthodox neo-classical theory. He clearly states that "from the perspective of economic theory, differing resource endowments or being a latecomer or undergoing reconstruction from war does not in itself constitute a market failure", so that he does not think "such items in themselves provide a case for policy intervention". In other words he rejects the use of industrial policies "to catch up with the industrialized nations or to improve the international competitiveness of domestic industry".

On the other hand, Prof. Murakami, who tried to construct anti-neoclassical political economy, defined the industrial policy in terms of long-term dynamic point of view. He placed it as a central policy tool of developmentalism. He defined it as "attempts to realize the advantages of decreasing cost", and stated that "the aim of industrial policy is to restrain excessive competition, or to sustain sufficient competition". In concrete terms, Murakami's industry policy consists of four types of policy tools: designation of priority industries; industry-specific indicative planning, policies to promote technological progress, and regulation of excessive price competition. Again he states that the industrial policy is neither a policy that increases an industry's growth rate through forcible, government intervention nor a means of implementing economic planning. Rather it is a kind of government intervention to maintain market competition when cost is decreasing. "This need is particularly acute in developing countries that are attempting to catch up with the advanced countries".

The differences in the definitions of industrial policy among scholars naturally lead to the differences in the evaluation of industrial policy. The prototype of industrial policy is that of Japan[1], so that the study of industrial policy concentrates on the Japanese case. However, as the idea of industrial policy transmits to the other East Asian countries, the contents of industrial policy have been changed. We can understand the experience of Japanese industrialization as a case of a late-comer. However, the experiences of the East Asian countries are that of the late-late-comers. Many arguments presuppose the homogeneity of Japanese industrialization and the industrialization of the East Asian countries, and they tend to argue that the Japanese industrial policy is representative of East Asian countries (Johnson 1982; Amsden 1989; Wade 1990). But this is a false generalization. We

1 However, maybe the first country that used the term "Industrial policy" was India. In 1947 India promulgated the first Industrial Policy Resolution. In Japan the term industrial policy was not widely used until around 1970s (Komiya 1988). Aoki suggests that industrial policy is not a Japanese innovation but that wartime prototype was inspired by the planning mechanism of the former USSR (Aoki 1996). Both cases show well that the industrial policy was an essential element of the early developmentalism.

should not miss the big differences between Japan and the East Asian countries in the contents of industrial policy and/or developmentalism. Johnson, for example, stresses the continuity of the Japanese political system and those of Korea and Taiwan, naming postwar Japan as a case of "soft authoritarianism" and naming those of Korea and Taiwan as a case of "hard authoritarianism" or "new cases of absolutist states". According to Johnson, Japan has been formally a democratic nation, but in essence Japan has been under a soft authoritarian rule because Japan has retained "an extremely strong and comparatively unsupervised state administration, single-party rule for more than three decades, and a set of economic priorities that seems unattainable under true political pluralism" (Johnson 1987). What a prejudiced view! Unnecessary worry! If he were correct, Independent India also should be a soft authoritarian country. Here we see again an old-fashioned dichotomy of Europe versus Non Europe (or Asia).

The "East Asian Miracle" report by the World Bank asserted that industrial policy narrowly defined, namely, to which that was promoting specific industries, "was generally unsuccessful" in Japan, Korea, Singapore, and Taiwan (World Bank 1993). On this judgment of the World Bank there is a lot of criticism and we still do not have any firm conclusions. However, to begin with, we should seek the significance of the industrial policy not in a variety of infant industry arguments but rather in the establishment of a shared information network between government and the private sector (Hayami 1998). Whether the information network between government and the private sector is established or not determines the success or failure of the government intervention for promoting specific industries.

3. The Early Developmentalism and the New Developmentalism

3-1 Common Characteristics and Differences

What are the common characteristics of and differences between the early and the new versions of developmentalism? Murakami's definition of developmentalism as "an economic system that takes a system of private property rights and a market economy as its basic framework, but that makes its main objective the achievement of industrialization, and, insofar as it is useful in achieving this objective, approves government intervention in the market from a long-term perspective", it can apply to both cases. Both forms of developmentalism share a strong economic nationalism which aims at attaining an independent national economy. And both forms of developmentalism pursued government guided economic management which aim to catch-up with the advanced countries. Theoretically we can say that developmentalism strove for industrialization through forced capital accumulation assuming an increasing return theory. Their attitudes towards direct foreign investment and foreign technology are also similar: a selective introduction based on domestic technology development. Furthermore they both share rigid regulation of banking and finance and exchange markets.

Then what are the differences between the two? The most conspicuous difference is that while the early developmentalism assumes import substituting industrialization strategy as a tool for attaining independent national economy, the new developmentalism assumes an export-oriented industrialization strategy. Closely related to this aspect is that although both of them presuppose the market failure hypothesis, the functioning of or the way of intervention of the government to the market is different. Not only in India but also in Korea or Taiwan, there was strong regulation of financial markets and there were strong industrial policies. However, in case of India, the government intervened with the market through replacing the private sector with the public sector, while in the case of Korea or Taiwan, the government guided and supplanted the private sector. Such a fundamental difference of the quality of government interventions is determined by the fact whether those interventions are established before or after "the neo-classical resurgence".

3-2 Relation between Industrialization and Democratization

Murakami tried to understand developmentalism as a universal concept, i.e., an "ideal type". After defining developmentalism as "a political-economic system established with the state as its unit", Murakami added that "thus in many cases some restrictions are placed on parliamentary democracy (such as a monarchical system, a one-party dictatorship, or a military dictatorship". And he contrasted the development patterns such as those of Japan or the East Asian countries with that of Anglo-American society. He called the former "developmentalism" and the latter "classical economic liberalism". The development path of the former, according to Murakami, is that of industrialization first and democratization later. In contrast, the development path of the latter is that of democratization first and industrialization later. Deepak Lal argued much more simply and straightforwardly. He states that "a courageous, ruthless and perhaps undemocratic government is required to ride roughshod over these newly-created special interest groups" (Lal 1983). All these arguments are based on the experiences of the East Asian countries such as Korea.

The early developmentalism assumes the concentration of the power in the central government. In so doing it presupposes an omnipotent, unselfish or benevolent government. On the other hand the new developmentalism presupposes an efficient, competent, or far-sighted government. In concrete terms the former presupposes a socialistic politico-economic system and the latter presupposes an authoritarian politico-economic system. In other words, both forms of developmentalism presuppose a government that is insulated from the vested interests. As a result of this presupposition, both forms of developmenatalism assume a strong or unerring government that can perform an autonomous policy management.

The new developmentalism is a trial of universalizing the collection of lessons that are deduced from the historical experiences of some high growth East Asian countries during the 1970s and 1980s, where the authoritarian political regimes were adopted. However, as is well known today, there is no unique relation between the selection of polity and economic performance (Przeworski & Limongi 1993). Still much less, there is no solid ground to assert that an authoritarian regime is necessary or indispensable for developing countries to make successful industrialization[2]. There are numerous examples of economic failure under the authoritarian regimes (North 1981, Ch.3; Bates 1988). In a nutshell, these arguments of developmentalism presuppose the assumption that "the strong government does not fail". This is not an anti-neoclassical argument, but simply a pre-neoclassical argument. What is to be questioned is not the choice of selected polity but the ability of governments to govern and ability of the government to formulate and perform coherent policies.

3-3 Developmentalism and Low Wage Labor

What are the essential elements for successful developmentalism? Lastly I consider this issue focusing just on the labor problem.

One of the most innovative concepts of early developmentalism is "disguised unemployment". Nurkse defined it as the case of a laborer whose marginal product of labor is zero (Nurkse 1953). Then, he argued, the government could deduce most of the people who engage in agriculture without decreasing agricultural products. In other words these disguised unemployed constitute potential savings for the society as a whole, because such unproductive redundant laborers are supported by the productive laborers.

Lewis' model of economic development with unlimited supply of labor also presupposes disguised unemployment (Lewis 1954). Lewis' model is a growth model that assumes abundant labor in developing

2 Bhagwati called the thesis that democracy necessarily handicaps development whereas authoritarianism aids it as the "cruel dilemma thesis". And he assessed this thesis as one belonged to "the old view" which was fashionable during the 1950s and 1960s (Bhagwati 1994).

countries. In such a country, according to Lewis, the marginal productivity of labor is very small so that the real wage level of the capitalist sector would be determined by the average productivity of agriculture, i.e., the subsistence level of wages. And as long as the subsistence sector remains, the unlimited supply of labor from the subsistence sector to the capitalist sector at the subsistence wage level would continue, so that the economic development could be brought about. This is the argument that shows the possibility of modern industrialization based on the low wages.

In short, early developmentalism assumed an unlimited availability of low wage laborers who supported the early industrialization. However, they did not make any further analysis of labor markets. They hardly discussed the role of education or skilled labor for successful industrialization.

Then what is the labor economics of the new developmentalism? The developing countries that adopted the new developmentalism are countries that succeeded in economic development because of export-led strategy. The neoclassical development economists found one of the reasons why the export-led strategy succeeded in the "free and flexible labor market" of the East Asian countries (World Bank 1993). However, what on earth was "the free and flexible labor market"?

Haggard argued that political weakness of labor class was the characteristics of Asian NICS. "Labor's political exclusion in all of the East Asian NICS gave state elite and the private sector a substantial degree of freedom" and made export-led growth possible. In Asian NICS there appeared an ironic combination, i.e., "equity without democracy" (Haggard 1990). Generally speaking in East Asian countries the competitive edge at the international market was based on their abundant cheap and educated labors. To ensure such cheap and educated labors, it was necessary to have both investment in human resources and an oppressive political regime.

However, the case of the East Asian countries in which politically oppressive regimes were built-in is a historically specific case. For successful export-led strategy in the international markets, the cheap and productive labor forces are indispensable factor, but the oppressive political regime is not necessarily indispensable to ensure such cheap and productive labors. The best example is Japan.

In Japan there was not a severe political oppression to the labor union. There the fundamental labor laws were enacted under the US occupation regime. The main factors that ensured the highly productive and cheap labor were the spread of school education and the formation of an internal labor market, which was supported by the long-term labor-management relations under lifetime employment, seniority-based wages and the promotion system.

For the late-comers to catching-up with the advanced economies, one of the lessons that we should draw from developmentalism is not a false message that a politically oppressive regime is necessary but rather that it is essential to construct a socio-economic system that ensures productive and cheap labor.

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